UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re: Pinnacle Airlines Corp. Reorganized debtor.	15cv1615 MEMORANDUM AND ORDER
Paolo J. Alfonso, *et al.*, Appellants, v. Pinnacle Airlines Corp., Appellee.	

WILLIAM H. PAULEY III, District Judge:

Appellants, forty-five individuals collectively referred to herein as the "Flight Training Creditors,"[1] appeal an order of United States Bankruptcy Judge Robert E. Gerber (the "Bankruptcy Court") reclassifying their priority claims under 11 U.S.C. § 507(a)(7) as non-priority general unsecured claims. For the following reasons, the Bankruptcy Court's order is affirmed.

BACKGROUND

Jet University, Inc. ("JetU") operated a now-defunct flight training school in Florida, which it claimed was "partnered" with Pinnacle Airlines Corporation ("Pinnacle"). JetU's website and marketing materials characterized JetU's flight training as being designed specifically for Pinnacle. The Flight Training Creditors paid in excess of $2,600 each to enroll in

[1] A complete list of the Flight Training Creditors is available at ECF No. 2, Exhibit A.

flight training school, allegedly hoping that Pinnacle would hire them as first officers (i.e. co-pilots) on their successful completion of JetU's training program.

It is undisputed that Pinnacle neither agreed to train the Flight Training Creditors nor received any of the monies they paid to JetU. When JetU ceased doing business, a number of prospective pilots filed lawsuits in Florida state court against JetU, and also named Pinnacle under theories of agency and vicarious liability.

On April 1, 2012, Pinnacle and its affiliates sought reorganization in a Chapter 11 bankruptcy (the "Pinnacle Bankruptcy"). On August 6, 2012 the Flight Training Creditors filed proofs of claim in the Pinnacle Bankruptcy, citing Pinnacle's "agency liability/tort consumer fraud re Jet University." Those proofs of claim designated $2,600 of each claim as priority claims pursuant to Section 507(a)(7) of the Bankruptcy Code. Pinnacle objected to the priority designation of the claims. On December 30, 2014, the Bankruptcy Court entered an order sustaining Pinnacle's objection. This appeal followed.

DISCUSSION

This Court has jurisdiction to hear appeals from final bankruptcy court orders pursuant to 28 U.S.C. § 158(a)(1). See In re Policy Realty Corp., 242 B.R. 121, 125 (S.D.N.Y. 1999), aff'd, 213 F.3d 626 (2d Cir. 2000). On appeal, the bankruptcy court's findings of fact are reviewed for clear error, and its conclusions of law de novo. See In re Manville Forest Prods. Corp., 896 F.2d 1384, 1388 (2d Cir. 1990).

Under the clearly erroneous standard, findings of fact that are supported by evidence may be reversed only if "the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." In re Grant Assocs., 154 B.R.

836, 840 (S.D.N.Y.1993) (quoting Anderson v. City of Bessemer, 470 U.S. 564, 573 (1985)).

The Bankruptcy Court's findings of fact were set forth on the record as follows:

> The claimants paid money to JetU for flight instruction, which in whole or in material part was not provided by JetU. JetU was mentioned by Pinnacle as a source of flight instruction on Pinnacle's Web site, and Pinnacle's name was used by JetU allegedly with Pinnacle's authority and/or acquiescence to induce those seeking pilot training to go to JetU, with the hope that they thereafter be hired by Pinnacle as first officers -- that is, co-pilots. It's undisputed that most or all of the claimants paid over money to JetU and did not get the training that they paid for. But Pinnacle has also introduced evidence which was not contradicted that Pinnacle never got any of the money that the claimants had forked over to JetU, as a deposit or otherwise. It didn't get it from the claimants, nor did JetU pass the money it received from the claimants onto Pinnacle.

In re Pinnacle Airlines Corp., 12-br-11343 (Bankr. S.D.N.Y.), Dkt. 1327 (Dec. 16, 2014 H'rg Tr. at 16:6-23). These findings of fact are not in serious dispute.

Section 507 of the Bankruptcy Code grants priority status to certain claims against debtors in bankruptcy, including the following:

> [A]llowed unsecured claims of individuals, to the extent of [$2,600][2] for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.

11 U.S.C. § 507(a)(7). Thus, to be entitled to priority status, the Flight Training Creditors must demonstrate that they have "allowed unsecured claims . . . arising from the deposit . . . of money in connection with . . . the purchase of services, for . . . personal . . . use . . . that were not delivered or provided." It is undisputed that each of them deposited money with JetU for the purchase of flight training lessons that were never provided. However, the parties dispute: (1) whether those flight training lessons were for "personal" use; and (2) whether § 507(a)(7) applies

[2] The amount of a claim entitled to priority is adjusted every three years. See 11 U.S.C. § 104(a). $2,600 represents the amount established when the Pinnacle Bankruptcy was commenced.

here even though Pinnacle neither received a deposit from the Flight Training Creditors, nor agreed to provide them with any services.

I. Services for Personal Use

Pinnacle argues that because the Flight Training Creditors sought lessons for piloting commercial aircraft, the services they purchased were commercial in nature and outside the scope of § 507(a)(7). Such a reading unreasonably restricts § 507(a)(7).

Section 507(a)(7) encompasses "the purchase of [personal] services." Here, the Flight Training Creditors deposited money for educational services. That the Flight Training Creditors may have hoped to use those educational services to obtain employment does not render those services any less "personal" in nature. For example, in In re Longo, 144 B.R. 305, 310-11 (Bankr. D. Md. 1992), the court found that the text and legislative history of § 507(a)(7) demonstrated that deposits for "educational service contracts which were not performed by [a vocational school]" were entitled to priority status under the statute. Here, like the students in In re Longo, the Flight Training Creditors "purchased a service contract for lessons which is literally covered by the section and supported by the section's legislative history. [JetU] had a consumer relationship with its students, and those students are among the class of creditors § 507(a)([7]) was designed to protect." In re Longo, 144 B.R. at 312. Pinnacle's attempt to equate educational services with items purchased by businesses for commercial purposes is unavailing. Accordingly, the Bankruptcy Court correctly held that the flight training services were for "personal, family, or household use."

II. Application of § 507(a)(7) to Pinnacle Via JetU

The Flight Training Creditors argue that § 507(a)(7) applies to their claims, and that Pinnacle is liable for JetU's wrongdoing under Florida partnership law.

"In interpreting a statute, we must first look to the language of the statute itself." Greenery Rehab. Grp., Inc. v. Hammon, 150 F.3d 226, 231 (2d Cir. 1998); see also Canada Life Assur. Co. v. Converium Ruckerversicherung (Deutschland) AG, 210 F. Supp. 2d 322, 326 (S.D.N.Y. 2002) ("When interpreting a statute's terms, courts first must look to the language of the statute itself.") Arguably, the plain language of § 507(a)(7) indicates that it might apply to the Flight Training Creditors' claims because their claims against Pinnacle arise from the deposit of money for personal services that were never delivered. Indeed, as the Bankruptcy Court noted, if JetU were the debtor, the Flight Training Creditors' claims would clearly be entitled to priority status. However, the issue here is whether § 507(a)(7) applies to a debtor, like Pinnacle, which neither received the deposit nor agreed to provide any services to claimants.

Courts have defined "deposit" in § 507(a)(7) as "the tendering of a consideration in order to purchase or rent specific property or services with the expectation that such consideration will be applied toward the purchase or rental of property or services, or be returned if either the property or services are not delivered or if the condition precedent for return of the consideration is fulfilled by the depositor." In re Glass, 203 B.R. 61, 64 (Bankr. W.D. Va. 1996) (emphasis added). Accepting that definition, the Flight Training Creditors' interpretation of § 507(a)(7) becomes problematic: Pinnacle cannot return property it never received, and cannot reasonably be expected to perform services it never agreed to perform. Additionally, "[t]he meaning of a particular section in a statute can be understood in context with and by reference to

the whole statutory scheme, by appreciating how sections relate to one another. In other words, the preferred meaning of a statutory provision is one that is consonant with the rest of the statute." Auburn Hous. Auth. v. Martinez, 277 F.3d 138, 144 (2d Cir. 2002); see also King v. Burwell, 135 S. Ct. 2480, 2483 (2015) ("oftentimes the meaning—or ambiguity—of certain words or phrases may only become evident when placed in context. So when deciding whether the language is plain, the Court must read the words in their context and with a view to their place in the overall statutory scheme.") (internal quotations & citations omitted). The context in which § 507(a)(7) must be read is the Bankruptcy Code, which "aims, in the main, to secure equal distribution among creditors." Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 655 (2006). For that reason, both the Supreme Court and the Second Circuit have held that provisions of the Bankruptcy Code granting priority to certain creditors and claims must be construed narrowly. See Howard Delivery Serv., Inc., 547 U.S. at 655 (2006) ("Preferential treatment of a class of creditors is in order only when clearly authorized by Congress."); Trustees of the Amalgamated Insurance Fund v. McFarlin's, Inc., 789 F.2d 98, 100 (2d Cir. 1986) ("Because the presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed."). These commands to interpret the scope of § 507(a)(7) narrowly weigh against the Flight Training Creditors' argument.

Moreover, the legislative history demonstrates that Congress only contemplated deposits held by the debtor when enacting § 507(a)(7):

> The purpose of this priority is to protect consumers who leave a deposit or lay merchandise away, and who do not receive the merchandise from the retailer who files a [bankruptcy] petition. A consumer that pays money on a layaway plan or as a deposit on merchandise, or that buys a service contract or a contract for lessons

> or a gym membership, is a general unsecured creditor of the business to which he had given his money. Very few consumers are aware of their status as general unsecured creditors. If the merchant involved files under the bankruptcy laws, the consumer is usually left holding the bag. Though he assumed his deposit was tantamount to a trust fund, he gets nothing from the estate of the debtor, because the assets available provide little return to unsecured creditors. Because of his ignorance and his inability to bargain with a retail merchant, he is unable to do a credit investigation or obtain special terms from the merchant, as a true creditor may do.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 188 (1977) (emphasis added). In sum, every reference to § 507(a)(7) in the relevant legislative report indicates that the priority should be read to apply to deposits held by the debtor.

The Flight Training Creditors' primary argument is that Pinnacle is liable for JetU's conduct under Florida partnership law. And while the Flight Training Creditors may be correct that Florida law provides them with a viable cause of action against Pinnacle, it is unlikely that Congress intended to graft such substantive (and potentially expansive) state law claims onto the narrow priorities set out in § 507(a). The Flight Training Creditors also cite In re Four Star Fin. Services, Inc., 444 B.R. 428 (C.D. Cal. Bankr. 2011) for the proposition that § 507(a)(7) does not require that a deposit be given to debtor. In Four Star, campground members paid deposits to a campground operator. Subsequently, the campground operator's assets and liabilities were purchased by a firm that later entered bankruptcy. The court held that, although the debtor was not the entity that initially received the deposit, claimants nevertheless held a priority claim. While Four Star thus supports the general proposition that "priority established by § 507(a) is not limited to payments and/or deposits received directly by the debtor," Four Star, 444 B.R. at 434 (emphasis added), that case is distinguishable because the debtor there—unlike Pinnacle—actually received the money that had been deposited, along with

the obligation to provide services. Accordingly, the Bankruptcy Court correctly held that deposits paid to JetU were outside the scope of § 507(a)(7).

CONCLUSION

For the foregoing reasons, the Bankruptcy Court's December 30, 2014 order is affirmed. The Clerk of the Court is directed to mark this case as closed.

Dated: July 27, 2015
New York, New York

SO ORDERED:

WILLIAM H. PAULEY III
U.S.D.J.

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